

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Public Utilities on its own motion into IntraLATA and Local Exchange Competition in Massachusetts

D. P. U. /D. T. E. 94-185-E

RESPONSE OF AT&T COMMUNICATIONS OF NEW ENGLAND, INC., TO VERIZON'S "JUSTIFICATION" FOR UNAUTHORIZED CHANGES TO ITS PRICE FLOOR CALCULATION

## Introduction

On August 24, 2000, Verizon filed revised price floor calculations ("August 24 Filing") purportedly pursuant to directives in the Department's August 3, 2000, order, D. P. U. /D. T. E. 94-185-E ("Price Floor Order"). In the Price Floor Order, the Department had directed Verizon, among other things, to use unseparated rather than separated expense data for purposes of calculating the "retail overhead expense factor." *Id.*, at 15-16. In its August 24 Filing Verizon accordingly made the adjustment in expenses that the Department had directed, but without explanation adjusted revenue calculations as well. On September 12, 2000, in its letter comments on the August 24 Filing, AT&T noted those revenue adjustments and stated that, since those adjustments were not authorized by the Department, they were - in the absence of any justification - in violation of the Department's Price Floor Order.

In its October 11, 2000, "reply" comments, Verizon belatedly offered an explanation for the revenue adjustments and - in an action of true audacity - complained that AT&T's questioning of the revenue adjustments is a "disingenuous" "narrow reading" of the Department's Price Floor Order. See, October 11, 2000, letter from Keefe B. Clemons ("Verizon October 11 reply comments"), at 2. Apparently, Verizon believes that it may make - without any accountability - whatever changes it pleases to the price floor calculation that the Department directed it to make.

There is good reason for Verizon's frustration at being called to task on the unauthorized revenue adjustments. Verizon has been caught with its proverbial "hand in the cookie jar." An analysis of Verizon's purported justification shows that the justification simply does not hold up. In fact, Verizon is trying to sneak into the new calculation revenue changes that are - in some cases - not even related to the change from separated to unseparated expenses and that are - in all cases - not justified by the change in expense data ordered by the Department.

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As has been often stated in this case, "at a minimum, this price floor requires that NYNEX's toll rates exceed the relevant access rate plus NYNEX's marginal cost of related overhead." D.P.U. 94-50, at 249-250 (emphasis added). The retail overhead expense factor is designed to calculate the amount of the "marginal cost of related overhead." Specifically, the factor is designed to measure the proportion of total expenses of a particular service that is "related to" or "caused by" retail functions. It is estimated by dividing the retail related expenses of a particular service by the revenues of that particular service.

There is no dispute that it is important to maintain consistency between the numerator and the denominator. See, Verizon October 11 reply comments, at 2. The services for which revenues are used in the denominator should be the same as the services for which expenses are used in the numerator. Verizon's revenue adjustments made in its August 24 Filing violate this basic principle.

A comparison of Workpaper 4, page 3 of 3, in the November 2, 1998 filing to Workpaper 3, Tab 2, in the August 24 Filing reveals five upward revenue adjustments.

A new revenue account has been added to the August 24 Filing: Account 5081. This account records End User Common Line ("EUCL") revenues. As a result of this additional account, Verizon has increased the denominator (which decreases the overhead retail factor) by \$208 million additional revenues.

The revenues in Account 5100 have been increased by \$13 million from \$294 million in the November 2, 1998, filing to \$307 million in the August 24 Filing. Based on Attachment 1 to Verizon's October 11, 2000 "reply" comments, this account has something to do with public and semi-public telephones.

Account 5264 has also been added to the August 24 Filing, with the effect of increasing the denominator by another \$10 million. Verizon has not even identified this adjustment in its reply comments, let alone explain it.

Account 5280 has also been added to the August 24 Filing, with the effect of increasing the denominator by another \$84 million. Based on Attachment 1 to Verizon's October 11, 2000 "reply" comments, this account records "non-regulated operating revenue."

Verizon identifies a small adjustment within Account 5010. While the adjustment itself is de minimus and does not therefore warrant discussion, the original inclusion of this account (and thus its continuing inclusion) should be rejected.

None of these five items of revenue should be included in the denominator because they do not relate to the services for which the retail expenses are calculated in the numerator. The reasons for this conclusion are set forth below.

## Argument

### I. EUCL Charges (Account 5081) Should Be Excluded From Revenues In the Determination Of The Retail Overhead Factor.

The EUCL charge, although collected directly from retail customers, is not revenue from the sale of local services for which retail expenses are being incurred. Including such revenue in the denominator of the retail overhead expense factor would therefore destroy the consistent and symmetrical ratio of retail costs and the corresponding revenues, a symmetry that even Verizon recognizes must be maintained to properly calculate the retail expense factor. See, October 11 reply comments, at 2.

End User Common Line charges must be excluded from the denominator because they are

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not revenue from the sale of the local services for which retail expenses are being incurred. In understanding why this is the case, it is necessary to review exactly what the EUCL charge is and what it was designed to accomplish. In 1983, the Federal Communications Commission issued rules requiring that telephone subscribers pay a monthly, flat rate charge for each telephone line. 47 C.F.R. § 69.104. That charge, also known as the "subscriber line charge" or "SLC" was designed to recover some of the embedded costs of the local exchange carriers' telephone lines, known as subscriber loops, which are necessary for the completion of long distance, as well as local, calls. In the Matter of Petition of SoundNet Emergency Communications for a Declaratory Ruling Interpreting Section 69.104 of the Commission's Rules, Order, CC Docket 96-1919, rel. November 18, 1996 ("SoundNet Order"), ¶ 2. In short, as the FCC recognized, the SLC is simply an interstate access charge collected directly from the end user on the end user bill:

The SLC is a component of interstate access charges, not of intrastate local service rates. Consistent with the principles of cost-causation and economic efficiency, we have required the portion of interstate allocated loop costs represented by the SLC to be recovered from end users, rather than from carriers as with other access charges. Although the SLC is listed on end user monthly local service bills, this charge does not represent a "telecommunications service [an incumbent LEC] provides at retail to subscribers." Rather, the SLC, like other interstate access charges, relates solely to incumbent LEC interstate access services, which are provided to other carriers rather than retail subscribers and which we have concluded are not subject to the resale requirements of section 251(c)(4).

First Report and Order, FCC 96-325, In the Matter of Implementation of the Local Competition Provisions on the Telecommunications Act of 1996, CC Docket No. 96-98 (August 1, 1996) ("FCC's First Local Competition Order"), ¶ 984

In fact, there are no retail expenses associated with the EUCL charge. The costs recovered by the EUCL charge are not a function of retail expenses associated with providing a retail (e.g., non-network, billing and customer relation services). There is simply a line item on the retail customer's bill reflecting what is, in essence, a tax necessary to fund interexchange access services. Patently, the revenues associated with the EUCL charge are not generated by cost-creating processes that bear any relationship whatsoever to the retail marketing, billing and collection or other cost categories included in the numerator of the retail overhead factor. ILECs do not market or sell the EUCL. Because there are no retail costs associated with the EUCL charge -- in either the interstate or intrastate jurisdiction -- there are no retail expenses associated with it to be included in the numerator of the calculation.

II. To The Extent That Public And Semi -Public Telephone Revenues (Account 5100 and Account 5010) Are Revenues From Wholesale Services, They Should Be Excluded From The Determination Of The Retail Overhead Factor.

There is no dispute that the retail overhead expense factor is designed to measure the proportion of expenses for retail services that are caused by retail activities. By definition, expenses related to the provision of wholesale services should not be included in the numerator. Indeed, Verizon's October 11 reply comments so states: "Verizon considered only those accounts that are strictly retail in nature, thus eliminating all wholesale revenues from the calculation." Id., p. 2. Nevertheless, it is not at all clear that Verizon has done that.

Account 5010 records revenues from public telephones. Public telephone revenues are not necessarily retail revenues. Indeed, much of Verizon's revenue in this area arises from the provision of "public access lines" ("PAL") to the suppliers of pay phone services. The suppliers of payphone service will arrange for and place payphone equipment at a particular location. They pay Verizon for the public access lines, or PALs, necessary to connect the payphone equipment to the public switched

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network and then sell the use of the payphone to the public. The suppliers of payphone service must earn sufficient revenues to recover the cost of their payphone equipment, the cost of Verizon's PAL charges and all other business costs. In these situations, Verizon is providing a wholesale service to the suppliers of the retail payphone service.

Just as the revenues of its wholesale access service are not included in the denominator of the retail overhead factor, neither should the revenues from its wholesale service to payphone providers be included in the denominator.

III. Revenues Recorded In Account 5264 Have Not Been Shown To Relate To The Services For Which the Retail Overhead Factor Is Being Calculated And Should Therefore Be Excluded

Verizon has increased the revenues in the denominator by another \$10 million by including for the first time in its August 24 Filing Account 5264. Verizon not only failed to explain these additional revenues when it submitted its August 24 Filing; it failed even to identify, let alone explain, the \$10 million adjustment in this account in the belated "explanation" contained in its October 11 "reply" comments letter. Account 5264 is identified in the August 24 Filing merely as "Other Incidental Reg Rev." See, Workpaper 3, Tab 2. Verizon provides no explanation of whether these revenues have any relationship to the services subject to the current price floor analysis.

The Department should bring closure to a matter that Verizon has delayed for too long. Verizon's repeated attempts to adjust downward the retail overhead factor without explanation should not be rewarded. Verizon's efforts to take advantage of any opening given it must finally be denied.

IV. Revenues Earned From Non-regulated Activities (Account 5280) Should Be Excluded From The Determination Of The Retail Overhead Factor.

In its August 24 Filing, Verizon has included an additional \$84 million in the denominator which represent "non-regulated operating revenue." A review of Attachment 1 indicates that this revenue comes from such services as "inside wire" and "voice messaging." Verizon's use of the Department's order, which required it only to include in the numerator generally local expenses that have been allocated for jurisdictional purposes to the interstate jurisdiction does not, and cannot, justify the inclusion of non-regulated revenues. Indeed, after AT&T questioned the justification of such revenue adjustments in its September 12, 2000, letter, Verizon did not even attempt to justify in its October 11 reply comments this adjustment on the basis of the Department's Price Floor Order. It is truly disingenuous to have included such revenues without justification or even identification in a filing that is suppose to be for the sole purpose of complying with the Department's Price Floor Order.

Based on its October 11 reply comments, Verizon's justification for its belated inclusion of this \$84 million is that "the retail overhead expenses for those accounts are included (nonregulated)." Id., p. 2. Clearly, this has nothing to do with whether separated or unseparated data are used. The factual issue of whether, and if so, to what extent, there are retail overhead expenses related to non-regulated services in the numerator is an issue that should have been raised in the case-in-chief, not in a compliance filing related to an entirely different issue. AT&T has had no opportunity to test Verizon's assertions in this regard. (1) Moreover, the economic and policy issue of whether Verizon should be allowed to take advantage of its non-regulated revenues for purposes of implementing price floor regulation has not been raised, let alone explored.

Verizon's disingenuous attempt to use this compliance filing as a cover for making adjustments it should have raised for Department consideration in its case-in-chief should be rejected.

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Conclusion

For the reasons set forth above, the Department should reject Verizon's August 24 Filing and direct it to submit a price floor compliance filing that complies with the Department's Price Floor Order.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I caused a true copy of the above document to be served upon the attorney of record for each other party on October 24, 2000.

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1. 1 For example, Verizon may contend that there are retail expenses in the numerator related to the provision of such non-regulated services as voice mail simply because the same service representative that takes the order for the basic local telephone service also takes the order for voice mail. This is hardly justification for inflating the denominator with revenues from unregulated services.

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In any event, the nature and amount of the claimed expenses related to non-regulated services are factual issues that should have been litigated in the main case.